

STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 2000-10

March 21, 2000

Central Maine Power Company
Standard Rates for Energy and
Capacity Purchases

EXAMINER'S REPORT

NOTE: This Report contains the recommendation of the Hearing Examiner and is in draft order format. Parties may respond or except orally to this Report on March 23, 2000 at 2:00 p.m. in the Commission's Hearing Room. It is expected that the Commission will consider this report at its deliberative session on March 27, 2000.

I. SUMMARY

On January, 18, 2000, Central Maine Power Company (CMP) filed proposed short-term energy only (STEO) and energy and capacity rates¹ for the 12-month period beginning in March, 2000. In accordance with Chapter 360 § 4(C)(3), CMP proposed using the Commission-accepted bid from its Chapter 307 auction. Under the winning bid, CMP receives 2.79 cents per kWh for capacity and energy from qualifying facilities (QFs) with which CMP has contracts, and CMP's residential and small non-residential customers receive standard offer service at a price of 4.089 cents per kWh. The Independent Energy Producers of Maine (IEPM) and S.D. Warren objected to CMP's proposed short-term energy only (STEO) rate. We conclude that both the STEO and the energy and capacity rate should be 2.84 cents per kWh, which is the highest stand-alone bid received in CMP's Ch. 307 auction.

¹Chapter 360 §4(C)(2)(b) governs the calculation of STEO rates after restructuring. Chapter 360 § 4(C)(3)(b) governs the calculation of rates for energy and capacity after restructuring.

II. PROCEDURAL HISTORY

The IEPM, S.D. Warren and CMS Energy intervened in this proceeding. The Commission held a technical conference on March 6, 2000. IEPM, CMS and CMP participated in the conference. The participants at the technical conference generally discussed their positions on the issues raised by CMP's filing and agreed to a schedule for processing the filing. The Examiner asked that the parties include a discussion of the following issues:

1. The merits of the Advisors' suggestion that the highest stand-alone Chapter 307 bid be substituted for the linked bid;
2. Whether the value of capacity should be removed from either the proposed STEO rate (the Commission-accepted Chapter 307 bid) or the highest stand-alone Chapter 307 bid; and
3. What methodology should be used to determine the rate for energy and capacity.

The IEPM and CMP filed briefs on March 15, 2000. S.D. Warren filed a letter stating its agreement with the IEPM's comments.

III. PARTIES' POSITIONS

The IEPM and S.D. Warren initially argued that the bid of 2.79 cents per kWh did not reflect the market price of energy in Maine because the bid was linked to the bid for standard offer service. According to the IEPM, the supplier of standard offer service would have bid a higher price for standard offer service if the bid were not linked to a "below-market" bid for buying QF output. After the Advisors suggested that this issue could be resolved by using the highest stand-alone bid for QF output in the Chapter 307

auction process, the IEPM argued that none of the bids represented the market price of energy because the low bid prices reflected some of the risk factors inherent in locking in a price over a one-year period. One of the uncertainties was the amount of load that bidders would be provided by the bidders. Another uncertainty was the difficulty in projecting the price of energy a year in advance.

In its brief, the IEPM argued that because the Chapter 307 bids are below the historic monthly ISO-NE Energy Clearing Price, the current ISO-NE energy prices and the NEPOOL forward energy prices, none of the bids can be used to determine STEO rates. IEPM advocated for the Commission to set STEO rates for the next twelve months at the actual ISO-NE market energy clearing price *if all parties agree to use this method*. Otherwise, the IEPM argued that the Commission should base the STEO rate on an estimate of the price for wholesale purchases of energy in Maine for the next 12 months. The IEPM did not address the question of whether the value of capacity should be removed from the proposed STEO rate or the highest stand-alone Chapter 307 bid.²

CMP opposed setting STEO rates at the actual ISO-NE market energy clearing price and supported setting the STEO rates based on the highest stand-alone bid (2.84 cents per kWh). CMP asserted that the Chapter 307 bids represent the market value of QF energy and capacity on a one-year basis. Because the highest stand-alone bid was a bundled price for energy and capacity, CMP argued that, for purposes of setting the STEO rate, the value of capacity should be removed from that bid to set the price paid

² IEPM's objection also focused only on the STEO rate, not on the rate for setting energy and capacity.

for energy only. The value of capacity, as estimated by CMP (based on other Chapter 307 bids that unbundled energy from capacity), is 0.14 cents per kWh. Thus CMP proposed that the Commission set the STEO rate equal to 2.70 cents per kWh and set the energy and capacity rate equal to 2.84 cents per kWh. CMP further argued that “the rate paid by CMP for STEO purchases be no greater than 2.79 cents per kWh, since this is the rate that CMP will receive under its contract to sell the QF output to Engage Energy.” CMP is concerned about the creation of additional stranded costs and its ability to collect such additional stranded costs under the Restructuring Act.³

IV. DISCUSSION

A. Background

1. The Standard Offer Bid Process

While CMP was conducting the Chapter 307 RFB process, the Commission was soliciting proposals to provide standard offer service to CMP customers. After receiving standard offer proposals in response to the RFB, the Commission rejected all proposals received for the service territories of CMP and BHE. After terminating the standard offer bid process for the CMP and BHE territories, the Commission initiated a new selection process, which allowed bidders to combine a proposal to provide standard offer service with a proposal to purchase the utility's QF and other Chapter 307 entitlements. As a result of the new selection process, the

³Under the Act, the Commission may not include in the stranded cost calculation, except in certain circumstances specified in the statute, “costs for obligations incurred on or after April 1, 1995.” 35-A M.R.S.A. §3208 (3).

Commission accepted a combined set of bids. Under the winning set of bids, Energy Atlantic will provide standard offer service to CMP's residential and small non-residential customers at a rate of 4.089 cents per kWh and Engage Energy will purchase CMP's QF entitlements (as well as certain other Ch. 307 entitlements) at a rate of 2.79 cents per kWh. *Central Maine Power Company, Selection of Winning Bidders for Sale of Electrical Capacity and Energy*, Docket No. 99-764 Order (December 3, 1999). The Commission did not accept a stand-alone bid of 2.84 cents for the purchase of CMP's entitlement to QF output even though prior to the initiation of the new standard offer selection process, CMP had sought Commission approval of the selection of the 2.84 cents per kWh bid under the 307 bid process.

2. The Rulemaking Amending Chapter 360

In 1998, we amended Chapter 360 to incorporate the requirements of the Restructuring Act. In the proposed rulemaking, the Commission proposed two alternatives for establishing STEO rates. One was to administratively set the rates for a 12-month period and the other was a formula approach. We described the formula approach as follows:

Under the formula approach, New England Independent System Operator (ISO) energy and capacity clearing prices would determine rates for purchases. Rates would change monthly. In any particular month, rates would equal the relevant ISO clearing prices in that same month of the prior year, adjusted up or down by the year-to-year change observed in the prior month. The formula is designed to produce rates each month for purchases of energy, or energy and capacity, from QFs that approximate New England market prices in that month.

Public Utilities Commission, Rulemaking on Qualifying Facility, Rates, Terms and

Conditions in Restructured Electric Industry (Chapter 360), Docket No. 97-794, Notice

of Rulemaking at 5 (October 31, 1997). The Consolidated QFs⁴ objected to the formula approach. They stated that the formula approach was inconsistent with section 7 of the Restructuring Act. Specifically, the Consolidated QFs argued that the legislation did not allow the Commission to establish a formula that produces a rate only a month in advance of the date in which the rate would be used. Rather, the Consolidated QFs argued that the Act required the Commission to set the rate in advance to apply for the 12 months following the establishment of the rate. The Consolidated QFs argued that "having the rate a year in advance provides budgeting and scheduling flexibility." Final comments of Consolidated QFs at 3, Docket No. 97-794. In addition, the Consolidated QFs argued that "using an ISO-New England market clearing price without any attempt to determine whether it reflects the price for purchases fails to account for the express language found in unallocated Section 7 of the restructuring bill. Only if Maine data is 'unavailable', is a New England market price to be looked at." *Id.* Finally, the Consolidated QFs recommended that the QF output sale price be a factor in setting energy only and energy and capacity rates, but not the only factor. The Consolidated QF's reservation about the use of this methodology, however, stemmed from CMP's QF output buy-back proposal, which was part of its divestiture plan. The Consolidated QFs concern appeared to be similar to the IEPM's initial concern in this case -- that linking the buy-back to the generation assets might result in bids that would not reflect the market price of the output.

⁴ The comments of the Consolidated QFs represented the views of the following entities: S.D. Warren, Maine Energy Recovery Company, the IEPM, Wheelabrator-Sherman Energy Company and Benton Falls Associates.

In adopting amendments to Chapter 360, we accepted neither of the alternatives in our proposed rule. Instead we adopted the approach suggested by CMP of basing the avoided cost rate on the price from the Chapter 307 sale of QF output.

We noted that this approach has several advantages:

[I]t will accurately reflect the market value of the power at the time of the sale; it will be easy to administer; it is consistent with the Act's directives; and it will eliminate the potential to create new stranded costs, because it precisely matches what the utility pays QFs with what the utility receives for the power in the market.

Public Utilities Commission, Rulemaking on Qualifying Facility Rules, Terms and Conditions in Restructured Electric Industry (Chapter 360), Docket No. 97-794, Order Adopting Amended Rule and Statement of Factual and Policy Basis at 3 (March 10, 1998).

B. Analysis

While we agree with the IEPM's and S.D. Warren's initial observation that the linking of the Standard Offer bid to the Ch. 307 bid places into question whether the bid for the QF output is below the market price, we disagree that the highest stand-alone bid should be disregarded. Rather, we conclude that the highest stand-alone bid does represent the market price for the QF output.

We first address the IEPM's argument that none of the Chapter 307 bids should be used to establish the STEO rate because even the highest of these bids is below historic, current or projected ISO energy clearing prices. First, we note that this argument is in direct contrast to the IEPM's position during the Chapter 360 rulemaking. In their final comments, the Consolidated QFs stated:

[T]he concept of using an ISO-New England market clearing price without any attempt to determine whether it reflects the price for purchases in Maine fails to account for the express language found in unallocated Section 7 of the restructuring bill. Only if Maine data is "unavailable" is a New England market price to be looked at.

Final comments of the Consolidated QF at 3, Docket No. 97-794. Here, the IEPM and S.D. Warren argue that CMP's proposed STEO rate, as well as the highest stand-alone bid, are below the market price for energy *because* they are below the ISO historic monthly clearing price, current ISO clearing prices and NEPOOL forward Energy prices. Thus, the IEPM and S.D. Warren appear now to oppose using the only direct, market-derived indicator of the value of energy and capacity provided by the QFs in Maine in favor of the ISO New England clearing price.

Second, we reject the IEPM's and S.D. Warren's claim that we should consider the *retail* standard offer prices in order to determine that the QF output bid prices do not reasonably reflect the *wholesale* cost of energy in Maine. The products provided by these two auction processes are too dissimilar for the price obtained in one to provide a useful measure of the value of the other. A power marketer bidding to supply standard offer service to residential customers, for example, would be expected to build into its price the risks associated with supplying a load of unknown size as well as the capacity, energy and all required ancillary services to serve that load for a one year period. We agree with CMP that the differing nature of the provision of standard offer service from the purchase of QF output prevents a meaningful comparison. In short, we do not consider the standard offer bids more reliable indicators of the wholesale cost of energy in Maine than what bidders were willing to pay for the QF

output. Thus the standard offer bids do not provide a reliable basis for rejecting the use of highest Chapter 307 stand-alone bid in setting energy only and energy and capacity rates.

Next we consider the IEPM and S.D. Warren's claim that the historic, current and NEPOOL forward energy prices indicate that the highest stand-alone bid should not be used to set the STEO. The IEPM and S.D. Warren argue that these figures indicate that the highest stand-alone bid is significantly lower than the historical, current, or projected ISO energy clearing prices. Therefore, the IEPM argues, if all the parties do not agree to using the actual ISO clearing price on a month-to-month basis for setting the STEO rates, the Commission should administratively determine the rates by making an estimate based on the historical, current, and projected ISO energy prices.

We are not convinced that deviating from the basic approach of the rule is warranted here. Chapter 360 uses a market-derived measurement mechanism to determine STEO and energy and capacity rates. This approach yields a more accurate indication of the value of the product being sold (at the time of the sale) as long as the bid process is truly competitive (and no party has argued here that the process was flawed). While the actual 307 bids may turn out to be below the actual energy clearing price over the next year, a certain risk differential is to be expected anytime a bidder commits to a price for an extended period of time based on projections of that item's future value. In addition, a Commission-determined estimate may also turn out to be as inaccurate, in hindsight, as a market-derived rate when compared to actual ISO clearing

prices. Faced with the statute's requirement to set the rates a year in advance, we see no reason to deviate here from the market-derived methodology set forth in the rule in favor of an administratively determined estimate.

We further note that the IEPM and S.D. Warren appeared to support consideration of these QF output bids in setting the STEO and energy and capacity rates, but expressed concern only because of CMP's inclusion of the "buy-back" proposal in its divestiture plan- -a course of action that was eventually abandoned by CMP.

Finally we note that the IEPM's proposal to use the actual ISO clearing price is conditioned upon the agreement by the parties to this approach. Because CMP does not agree to this methodology, we do not give further consideration to this proposal.

In summary, we conclude that the highest stand-alone bid provides the best indication of the value of the QF output as offered on the market. We reject the linked bid because it may reflect a reduced value for the QF output by benefiting ratepayers with a low standard offer bid. However, we also conclude that it is unreasonable to require ratepayers to pay rates that are significantly higher than that offered in the market for the QF output.

Having determined that the highest stand-alone bid represents the closest estimate of the market price for generation provided by the QFs, we must next determine whether the value of capacity should be removed from this bid. CMP argues that it should be removed, while the IEPM does not address this question. CMP argues

that capacity provided by these units has some value because some of the bidders provided separate capacity bids. We note, however, in its original filing that CMP did not propose to remove capacity from the "single energy price" bid. The underlying issue identified by CMP is that the unlinked bid without capacity removed is higher than the amount that it is being paid for the QF output. The result of using the unlinked bid without removing capacity is that either CMP or its ratepayers will be required to absorb the difference between the price paid and the price received for the QF output. CMP notes that "[I]t would be extremely unfair to require CMP to pay a Commission established rate, yet deny CMP a fair opportunity to fully recover the costs of paying such a rate. This result should be avoided at all costs." CMP Brief at 5.

First, we note that the difference between the rate received for the QF output (2.79 cents kWh) and the stand-alone bid without removing the value of capacity (2.84 cents kWh) is not of great magnitude.⁵ Second, we question the fairness of a solution to the linked bid problem that results in a STEO rate that is lower than the linked bid. Thus, we have not removed the value of capacity from the bid of 2.84 cents per kWh. However, we agree with CMP that it should have an opportunity to fully recover the difference between the price that it would have received for the QF output if the bid had not been linked and the price that it actually is receiving. We do not believe that providing this opportunity would be in violation of the statute's prohibition on new stranded costs, 35-A M.R.S.A. 3208 (3), because the obligations associated with these

⁵ The difference amounts to between approximately \$25,000 and \$45,000 per year depending on kWh per year that CMP would be required to pay for.

contracts were incurred prior to April 1995.⁶

Finally, we agree with CMP that 2.84 cents per kWh should be the price for energy and capacity. The IEPM and S.D. Warren only focused its objections to the STEO rates. Thus, there appears to be no dispute about the price for energy and capacity.

Dated: March 21, 2000

Submitted by,

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⁶35-A M.R.S.A. § 3208 (3) prevents the Commission from including in stranded costs "costs for obligations incurred on or after April 1, 1995" except in certain specific circumstances described in that section. Because all of the QF contracts at issue here were entered into prior to April 1, 1995, the costs associated with these pre-April 1995 obligations may be included in the stranded cost calculation.